

Illinois Insurance

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Opening Day and a New Strike Zone for the Financial Services Marketplace

—by Nat Shapo, Director

(Director Shapo's editorial appeared in the April 16, 2001, issue of the National Underwriter. Although it is a bit late in the season to talk about Opening Day, his baseball analogy is still timely.)

Intellectuals tell us that baseball is a metaphor for American life. As such, the rules changes in the major leagues this year strike a familiar chord with those of us struggling with the effects of recent statutory changes that are transforming the American insurance market.

In the just-concluded baseball spring training, umpires, under instructions from the commissioner's office, began enforcing a new strike zone. Pitchers and batters, whose entire careers depend upon their expectations and assumptions about this most fundamental aspect of the game, responded to the change with anxiety and trepidation. The *Chicago Tribune* described a manager who "expects to see far more confrontations between players and umpires once the season starts. There already have been several this spring."

Similarly, in the insurance world, our commissioner (Congress) recently changed the fundamental rules of the game. Our

Just as baseball umpires are now enforcing a new strike zone, so too has Congress recently changed the fundamental rules of the insurance game.

strike zone had been defined by the McCarran-Ferguson Act, which entrusts insurance regulation to the states, and the Glass-Steagall Act, which created barriers between insurance companies, banks, and securities firms. That all changed when the Gramm-Leach-Bliley Act opened the insurance market to all players, and set new rules governing competition. The umpires of this game, banking and insurance regulators, have been instructed to cooperatively enforce a new strike zone in a process known as "functional regulation." Insurance companies, agents, and banks—the pitchers and batters of this high-stakes

game—have questioned the umpires' interpretation of the rules since the first pitch of the new season. And just as baseball tries to gauge the reaction of its consumers (the fans) to the new strike zone, the effects of GLBA on insurance consumers is uncertain.

Many of the issues raised by the new insurance game have been contested on the diamonds of the National Association of Insurance Commissioners. NAIC working groups have begun implementing GLBA mandates such as uniformity in producer licensing and cooperation with federal regulators. Commissioners have also sought to construct a more streamlined product approval system in response to another rules change—the creation of a Financial Services Committee in the House of Representatives, chaired by an advocate of efficiency in the marketplace.

At the latest NAIC meeting, players and umpires argued about the meaning of the new rules of the game. Some industry groups complained that the pace of change was too slow. Consumer groups argued that the industry is taking advantage of worries about

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Opening day (cont'd from p. 1)

federal oversight to bluff regulators into ceding their legitimate authority to the vagaries of market forces. And the regulators, like umpires who can only be pushed so far, occasionally snapped back at their critics.

"The reality," writes the *New York Times'* baseball expert, "is no one knows what impact the new strike zone will have on Major League Baseball games this year." Similarly, no one knows if GLBA and the House Financial Services

Committee will propel us toward the federalization of insurance regulation. But, like baseball umpires who turn to their union for protection from pressures generated by the commissioner's office, regulators have turned to their trade group, the NAIC, for guidance in dealing with Congress. The NAIC has in turn served as an engine for prodigious work products through its committees, promulgating model laws and policy recommendations.

Now it is up to the umpires of the new insurance marketplace, the state insurance regulators, to call them as they see them back in their home states. If life truly begins on Opening Day, as a leading sportswriter has argued, then perhaps the birth of the new financial services marketplace will lead to a game of skill and fair play that, with the umpires applying a rational rulebook, is beneficial to players and fans alike. ♦

IL producers cautioned about securities schemes

-by Kelly Kruger, Producer Section

The Illinois Department of Insurance has learned of a fast-growing problem that affects the integrity of the legitimate insurance industry.

Licensed insurance producers are being recruited to market and sell investments that are unregistered securities and are sold in violation of state and federal securities laws. These investments include corporate promissory notes,

pay phone sale and leaseback plans, time-share vacation properties, ATM machines and so-called foreign bank investments. Not all of these investment plans are illegal or fraudulent, but they are almost always classified as securities and all securities must be registered with state regulators and sold only by people with securities licenses.

While the majority of producers are conscientious professionals who work hard to help provide life insurance and safe retirement investments to their clients, a growing number of producers are breaking the law.

Producers should be wary of solicitations mailed directly or appearing in magazines, which invite them to sell non-insurance financial products. Some of the promoters of these investments are actually engaged in "Ponzi" schemes whereby new investors' money is used to repay or pay interest or "profits" to earlier investors. Such an enterprise is not intended to generate legitimate profits and eventually collapses, leaving the promoters with most of the money and most of the investors empty-handed.

The Department of Insurance is advising Illinois producers to be cautious. Producers should thoroughly check any representations that an investment product is not subject to securities regulation. Such information could not only prove to be erroneous, but relying on it could jeopardize the producer's insurance license. Naiveté is not a defense against license sanctions and civil suits. ♦

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Director of Insurance Nathaniel S. Shapo
 Assistant Director Madelynne L. Brown
 Editor Nan Nases
 Graphics Shelley McQuern

First Oak Brook executive indicted

A federal grand jury has returned a nine-count indictment against Richard J. Murphy, the former financial controller of First Oak Brook Corporation Syndicate, Inc., and its parent company, United Financial Group, Inc. of Illinois. First Oak Brook was placed in liquidation in Illinois on November 12, 1996.

An insurance syndicate and underwriting member of the Illinois Insurance Exchange (now known as INEX), First Oak Brook wrote primarily commercial property insurance in approximately 40 states, covering such business as motels, restaurants and bars. It ceased doing business in September 1996, leaving more than \$25 million in unpaid claims.

As a member of the Illinois Insurance Exchange, First Oak Brook was required to submit accurate financial information on a quarterly and annual basis. According to the indictment, Murphy was responsible for maintaining complete and accurate financial books and records for United Financial Group and its subsidiaries, including First Oak Brook, and providing information to independent auditors.

Murphy's indictment alleges that he failed to disclose that First Oak Brook had obtained loans from Capitol Bank of Westmont of \$1 million in October 1995 and \$2.5 million in January 1996, and that he made the following false statements on the company's financial reports:

- that First Oak Brook had certificates of deposit at Harris Bank totaling \$4,294,913;
- that First Oak Brook had a surplus on December 31, 1995, of \$10,179,085;
- that First Oak Brook's 1995 year-end financial statement fairly presented its financial position;

- that First Oak Brook had collected \$4 million in "subscriptions receivable";

- that First Oak Brook had collected \$3.8 million pursuant to a "management agreement"; and

- that First Oak Brook had a surplus on March 31, 1996, of \$10,089,643.

In announcing the indictment on May 15, Scott Lassar, U.S. Attorney for the Northern District of Illinois, commended the assistance of Illinois Insurance Director Nat Shapo, as liquidator of First Oak Brook.

"Insurance regulation, to a large extent, depends on self reporting," Shapo said. "Richard Murphy's indictment sends a message that insurance companies and their

officers cannot willfully deceive the Department of Insurance and the public about their financial position. I'm very pleased that the federal authorities pursued and secured this indictment."

An indictment contains only charges of wrongdoing. The defendant's guilt will be determined at trial. A conviction carries a maximum penalty of 10 years in prison and a \$250,000 fine on each count. As an alternative maximum fine, the Court may order a fine totaling twice the gross loss to any victim or twice the gain to the defendant, whichever is greater. Restitution is mandatory, although the Court would determine the appropriate sentence to be imposed under U.S. Sentencing Guidelines. ♦

Liquidation orders final

The Circuit Court of Cook County Illinois issued an Order of Liquidation against **Illinois Environmental Services Workers Compensation Trust** on March 22, 2001, based on the Department of Insurance's findings that the group workers compensation self-insurance pool was insolvent by at least \$3 million. Environmental had been in conservation since July 31, 2000.

Environmental was unable to recover adequate funds from its members to cure the deficiencies in its financial condition, and the Director moved to place the company into liquidation for the protection of claimants and creditors. Simultaneously, the Director as Liquidator has ceased paying all claims. As of December 31, 1999, Environmental reported earned premium of \$1.4 million and a net loss of approximately \$950,000. The Liquidation Order contains an injunction prohibiting suits against

Environmental outside of the liquidation proceedings. Under the Illinois Workers Compensation Act, a group workers compensation pool insolvency fund can be activated when the Director determines that compensation or medical services provided by the Act may be unpaid by reason of default. Although the fund currently has limited monies, claimants interested in pursuing claims should contact Robert Enoex, Illinois Department of Insurance, (217) 782-2867.

On April 4, 2001, the Illinois Supreme Court denied **Alpine Insurance Company's** petition for leave to appeal a Cook County Circuit Court liquidation order entered on June 28, 2000. The liquidation was based on the Department's finding that Alpine was insolvent by over \$2.5 million. Company ownership appealed to the Illinois First District Appellate Court, which upheld the liquidation on December 21, 2000, and

(cont'd on p. 5)

Producer regulatory action

(Copies of regulatory orders are available upon written request to the Producer Regulatory Unit, for \$1/page. The number of pages are indicated in parentheses following the effective date.)

Stipulation and Consent Order— Civil Forfeiture Paid

Angela Cooper
252 N. Keeler Ave., Apt. 2A
Chicago, IL 60624
Effective 04/16/01 (5)

Mark S. Marko
1122 North Ave
Rockford, IL 61103
Effective 02/21/01 (5)

Midwest Members Insurance
Services Inc.
5906 Elaine Dr
Rockford, IL 61108
Effective 02/21/01 (5)

Alex E. Oliver Sr.
339 Warwick St
Buffalo, NY 14215
Effective 02/20/01 (3)

Michael K. O'Malley
1943 Jahns Dr.
Wheaton, IL 60187
Effective 04/18/01 (3)

Paul D. Patton
#13 Garfield, PO Box 263
Crescent City, IL 60928
Effective 02/20/01 (4)

Revocation of Producer License

Andrew C. Chervinko
1526 Old Forge Rd
Bartlett, IL 60103
Effective 03/15/01 (2)

Denial of Producer License

Alfred P. Divittorio
3029 Lincoln Trail
Crestwood, KY 40014
Effective 03/15/01 (5)

Julio Padilla
2443 S. Laramie
Cicero, IL 60804
Effective 04/23/01 (3)

Suspension of Producer License

Kelly B. Crowley
25800 W. Highpoint
Ingleside, IL 60041
Effective 04/23/01 (2)

David Torres
10520 Richcove Dr., Apt 13 B
Chicago, IL 60415
Effective 04/23/01 (2)

Voluntary Revocation of Producer License

Terry L. Spirk
280 W. Shuman Blvd., Suite 110
Naperville, IL 60563
Effective 03/30/01 (1)

Michael Timbrook
217 Falcon Dr
Green Valley, IL 61534
Effective 03/30/01 (1) ♦

Exam reports filed

Financial

Addison Insurance Company
4/06/01
Allstate Floridian Indemnity Co.
3/07/01
Allstate Floridian Insurance Co.
3/07/01
Allstate Indemnity Company
3/07/01
Allstate Insurance Company
3/07/01
Allstate New Jersey Insurance
Co.
3/07/01
AMEX Assurance Company
4/06/01
Holy Family Society of the
United States of America, The
5/04/01
Marshall Mutual Insurance Co.
4/17/01
Not-For-Profit Insurance Trust
5/02/01
Planet Indemnity Company
4/06/01
Unique Insurance Company
4/10/01

Market Conduct

Mega Life Insurance Company
3/19/01
Travelers Property Casualty
Insurance Company
4/17/01
Badger Mutual Insurance
Company
5/08/01 ♦

Staff announcements

Dan Smolak, Financial Examination Section, has earned the Certified Financial Examiner (CFE) designation through the Society of Financial Examiners.

Robert Rapp, Producer Regulatory Unit, and **Lynn Shanklin**, Life Actuarial Section, have earned Accredited Insurance Examiner (AIE) designations from the Insurance Regulatory Examiners Society. ♦

Liquidation (cont'd from p. 3)

subsequently filed the unsuccessful petition for leave to appeal to the Illinois Supreme Court.

Alpine had been in a runoff mode since approximately July 1996, and was placed under an Agreed Order of Conservation on January 8, 1999. The company's most recent financial statements reflect total direct premium of \$14.5 million in 1996 and \$6.7 million in 1997. The company wrote commercial liability and property coverages as well as product liability on a licensed basis in Illinois and on an excess and surplus line basis in 29 other states and the District of Columbia.

The Illinois Insurance Guaranty Fund will be responsible for the covered claims of Alpine's Illinois policyholders. The Order of Liquidation contains an injunction prohibiting suits against Alpine outside of the liquidation proceedings.

Liquidation proceedings are handled on behalf of the Director of Insurance by the Office of the Special Deputy Receiver, 222 Merchandise Mart Plaza, Suite 1450, Chicago, Illinois 60654, (312) 836-9500. ♦

Department rules review

The full text of Department rules is printed in the *Illinois Register* published weekly by the Illinois Secretary of State's Index Department, 111 E. Monroe St., Springfield, IL 62756. Subscriptions are available from that source for an annual fee of \$290. Issue numbers and a Department contact person are listed below after each rule summary.

Copies of rules are also available upon written request to the Department of Insurance at a \$1 per page charge. Some rules are posted on the Department's website at www.state.il.us/ins/industryinfo.htm. Adopted rules are codified in Title 50 of the Illinois Administrative Code.

Rule 806 (Derivative Instruments) was amended effective March 15, 2001. Sections 126.18 and 126.31 of the Illinois Insurance Code [215 ILCS 5/126.18 and 126.31] prohibit insurers from using derivative instruments for replication and synthetic asset transactions until "the Director promulgates reasonable rules that set forth methods of disclosure, reserving for risk based capital, and determining the asset valuation reserve for these investments." The NAIC has adopted changes to the annual statement blank, specific accounting rules, and spe-

cific requirements for risk based capital treatment of derivatives used for replication transactions. Our regulatory requirements use each of these components. The proposed amendment to Part 806 lifts the prohibition against the use of derivative instruments for replication and synthetic asset purposes. (Vol. 25, #13; Larry Gorski).

Rule 1451 (Variable Contract Rule) was amended effective March 5, 2001. Part 1451.50(b) requires insurers to file with the Department the effective prospectus that is applicable to variable contracts issued in Illinois. Historically, the Department has never found reason to refer to the prospectuses and so to save the time and the cost to microfilm and store the prospectuses, the Department is eliminating that filing requirement. Additionally Section 1451.50(d) will be added requiring insurers to notify the Department of the effective date and file number that the Securities and Exchange Commission has assigned the applicable variable contract before the Department can approve such contract. These amendments will also more accurately reflect the Department's examination requirements for obtaining a variable contract producer's license. (Vol. 25, #12; Chuck Budinger). ♦

New Illinois privacy rules consistent with GLB Act

The Department of Insurance has filed the Notice of Final Adoption for **Part 4002** (Personal Information and Privacy Protection) with the Secretary of State's Office. The rule complies with certain requirements set forth in the federal Gramm-Leach-Bliley Act pertaining to the privacy of financial information gathered for and con-

cerning customers of financial institutions. Those requirements apply to entities regulated by the Department of Insurance.

The Department has already adopted a rule (50 Ill. Adm. Code 4001) that authorizes the Director to enforce the privacy requirements, and establishes a compliance date of July 1, 2001. Part

4002 addresses in greater detail the underlying requirements placed on those being regulated. At press time, the publication date in the *Illinois Register* had not been confirmed. However, the text of Part 4002 is available on the Department's website. Questions on the rule should be directed to Chuck Feinen at (217) 557-1396. ♦

Hearings

Scheduled Hearings:

Evelyn Walton
General Casualty Co. of Illinois
Hearing No. 3837
Nonrenewal 5/16/01

Maria McCarty
Illinois Farmers Insurance Co.
Hearing No. 3840
Nonrenewal 5/17/01

Albert B. Wendt
State Farm Fire & Casualty Co.
Hearing No. 3841
Nonrenewal 5/31/01

Settled Without Hearing:

Robert D. Moller
Hearing No. 3829
Dismissed 4/23/01

Jerrold & Charlene Snider
American Family Mutual
Insurance Company
Hearing No. 3828
Dismissed 3/23/01

Leona Stover
Economy Preferred Insurance Co.
Hearing No. 3838
Dismissed 5/8/01

Michael Timbrook
Hearing No. 3823
Dismissed 4/9/01

Completed Hearings:

Argus Health Plans, Inc.
Dean Tucci
Hearing No. 3814
Cease and Desist made
permanent 5/8/01

Emma J. Bosworth
Hearing No. 3825
Order of Revocation effective
6/1/01

Timothy D. Jefferson
Hearing No. 3830
Nonrenewal effective 5/8/01

Robert L. Munoz
Hearing No. 3817
Denial of request for license
rescinded 4/3/01

Godfrey & Misti Thomas
Westfield National Insurance Co.
Hearing No. 3827
Cancellation effective 4/24/01 ♦

Company action

Market Conduct Fines

The following entities were issued Stipulation and Consent Orders and fined for Insurance Code violations and/or improper claims practices cited in their Illinois market conduct examinations:

AIG Life Insurance Company,
DE, 5/16/01; \$5,000

Badger Mutual Insurance
Company, WI, 5/1/01; \$15,000

New Admissions

Nipponkoa Insurance Com-
pany of America, NY, 4/1/01

Specialty Surplus Insurance
company, IL, 4/10/01

Terminations

Great States Insurance
Company, CA, and HIH America
Compensation & Liability
Insurance Company, CA, placed
in liquidation in California
5/8/01; Illinois certificates of
authority suspended
5/1/01-4/30/03

Union and Phenix Espanol
Insurance Company, Madrid,
Spain, voluntarily surrendered
certificate of authority 4/11/01. ♦

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